



# **U.S.-Mexico Economic Relations: Trends, Issues, and Implications**

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## Summary

Mexico has a population of about 111 million people, making it the most populous Spanish-speaking country in the world and the third-most populous country in the Western Hemisphere. Based on a gross domestic product (GDP) of \$875 billion in 2009 (about 6% of U.S. GDP), Mexico has a free market economy with a strong export sector. Economic conditions in Mexico are important to the United States because of the proximity of Mexico to the United States, the close trade and investment interactions, and other social and political issues that are affected by the economic relationship between the two countries.

The United States and Mexico have strong economic ties through the North American Free Trade Agreement (NAFTA), which has been in effect since 1994. In terms of total trade, Mexico is the United States' third-largest trading partner, while the United States ranks first among Mexico's trading partners. In U.S. imports, Mexico ranks third among U.S. trading partners, after China and Canada, while in exports Mexico ranks second, after Canada. The United States is the largest source of foreign direct investment (FDI) in Mexico. These links are critical to many U.S. industries and border communities.

In 2009, 12% of total U.S. merchandise exports were destined for Mexico and 11% of U.S. merchandise imports came from Mexico. After increasing 10% in 2008, U.S. exports to Mexico decreased 19.6% in 2009 as a result of the global financial crisis and the effect on the U.S. economy. Imports from Mexico decreased 18.5% in 2009, after a 3% increase in 2008. For Mexico, the United States is a much more significant trading partner. Over 80% of Mexico's exports go to the United States and 48% of Mexico's imports come from the United States. The stock of U.S. FDI in Mexico totaled \$95.6 billion in 2008. The overall effect of NAFTA on the U.S. economy has been relatively small, primarily because two-way trade with Mexico amounts to less than 3% of U.S. GDP. Major trade issues between Mexico and the United States since NAFTA have involved the access of Mexican trucks to the United States; the access of Mexican sugar and tuna to the U.S. market; and the access of U.S. sweeteners to the Mexican market.

Over the last decade, the economic relationship between the United States and Mexico has strengthened significantly. The two countries continue to cooperate on issues of mutual concern. President Barack Obama met with Mexican President Calderón and Canadian Prime Minister Harper at the North American Leaders' Summit in Guadalajara, Mexico, in August 2009 to discuss key issues that affect the three countries. They agreed to continue cooperation in North American competitiveness and security.

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## Introduction

The bilateral economic relationship with Mexico is of key interest to the United States because of Mexico's proximity and because of strong cultural and economic ties between the two countries. Mexico has a population of 111 million people, making it the most populous Spanish-speaking country in the world and the third-most populous country in the Western Hemisphere (after the United States and Brazil). The economic relationship with Mexico has strengthened considerably under the North American Free Trade Agreement (NAFTA), with trade between the two countries more than tripling since the agreement was implemented. Through NAFTA, the United States, Mexico, and Canada form the world's largest free trade area, with about one-third the world's total gross domestic product (GDP).

The United States and Mexico share common interests and are closely tied in areas not directly related to trade and investment. The two countries share a 2,000 mile border and have extensive interconnections through the Gulf of Mexico. There are links through migration and tourism, environment and health concerns, and family and cultural relationships.<sup>1</sup> The economic relationship with Mexico is important to U.S. national interests and to the U.S. Congress for many reasons. The 111<sup>th</sup> Congress will likely maintain an active interest in Mexico on issues related to counternarcotics, economic conditions, migration, trade, and border issues. Comprehensive immigration reform was debated early in the 110<sup>th</sup> Congress, and immigration reform efforts could be considered once again in the 111<sup>th</sup> Congress.

This report provides an overview of U.S.-Mexico trade and economic trends, the Mexican economy, the effects of NAFTA, and major trade issues between the United States and Mexico. This report will be updated as events warrant.

## U.S.-Mexico Economic Trends

The size of the Mexican economy is much smaller than that of the United States. Mexico's gross domestic product (GDP) was an estimated \$875 billion in 2009, about 6% of U.S. GDP of \$14.3 trillion. The Mexican economy is very much tied to the U.S. economy because of Mexico's reliance on the United States as an export market and the relative importance of exports to its overall economic performance. Exports accounted for 26% of Mexico's GDP in 2009 (see **Table 1**). The United States is, by far, Mexico's most important partner in trade and investment, while Mexico is the United States third-largest trade partner after China and Canada. Many economists have focused much attention on the ongoing transformation of Mexico into a manufacturing-for-export nation since the late 1980s and the importance of exports to its economy. After oil and gas, most of Mexico's exports are manufactured goods. Over 80% of Mexico's exports are headed to the United States.

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<sup>1</sup> For more information on issues related to Mexico, see CRS Report RL32724, *Mexico-U.S. Relations: Issues for Congress*, by Clare Ribando Seelke.

**Table I. Key Economic Indicators for Mexico and the United States**

	Mexico		United States	
	1999	2009 <sup>a</sup>	1999	2009 <sup>a</sup>
Population (millions)	99	111	279	307
Nominal GDP (\$US billions) <sup>b</sup>	520	875	9,354	14,258
GDP, PPP <sup>c</sup> Basis (\$US billions)	969	1,611	9,354	14,258
Per Capita GDP (\$US)	5,277	7,870	33,520	46,480
Per Capita GDP in \$PPPs	9,825	14,480	33,520	46,480
Total Merchandise Exports (US\$ billions)	136	230	696	1,057
Exports as % of GDP <sup>d</sup>	28%	26%	11%	11%
Total Merchandise Imports (US\$ billions)	142	234	1,025	1,558
Imports as % of GDP <sup>d</sup>	30%	29%	13%	14%
Public Debt/GDP	44%	39%	39%	47%

**Source:** Compiled by CRS based on data from Economist Intelligence Unit (EIU) on-line database.

**Notes:** Click here and type the notes, or delete this paragraph

- a. Some figures for 2009 are estimates.
- b. Nominal GDP is calculated by EIU based on figures from World Bank and World Development Indicators.
- c. PPP refers to purchasing power parity, which reflects the purchasing power of foreign currencies in U.S. dollars.
- d. Exports and Imports as % of GDP derived by EIU.

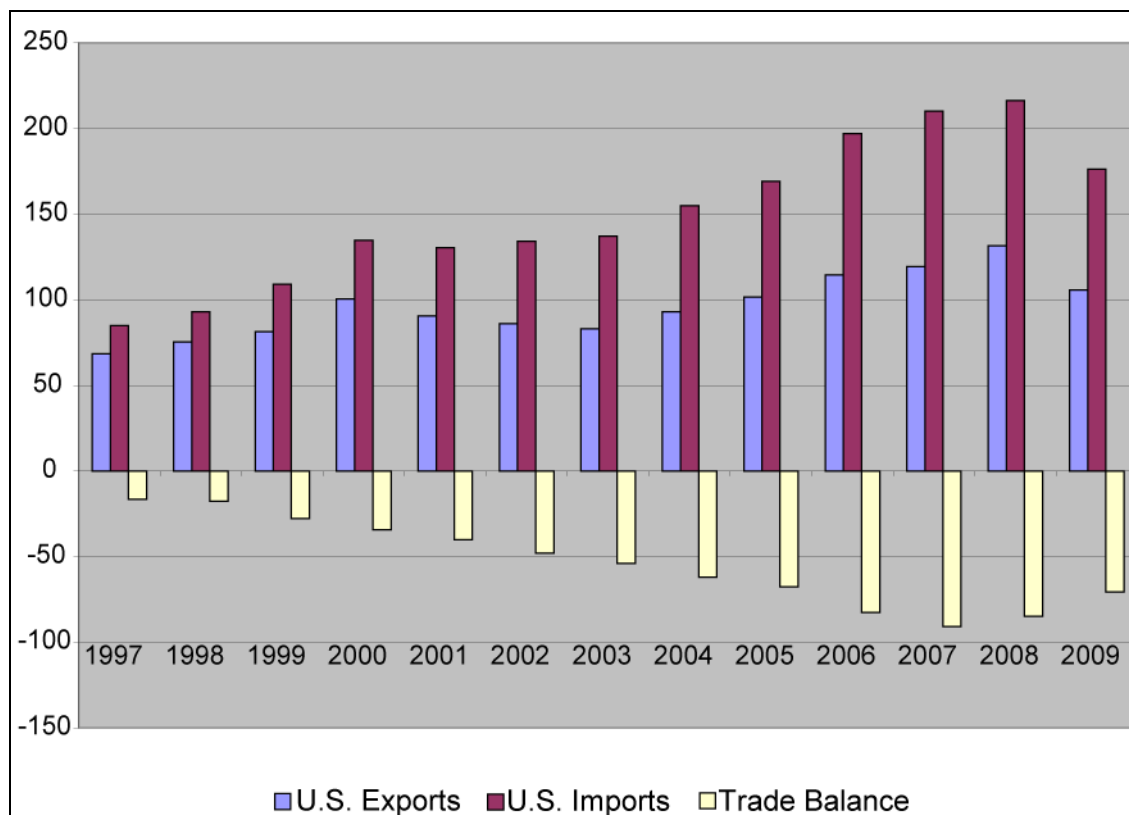
Mexico's reliance on the United States as a trade partner appears to be diminishing, although slightly. Between 2004 and 2009, the U.S. share of Mexico's total imports decreased from 56% to 48%, while the share of total Mexican exports going to the United States decreased from 89% to 81%. Mexico's share of the U.S. market has lost ground since 2002. In 2003, China surpassed Mexico as a top supplier of U.S. imports, and Mexico now ranks third, after China and Canada, as a source of U.S. imports. Because over 80% of Mexico's exports are destined for the United States, any change in U.S. demand can have strong economic consequences in Mexican industrial sectors. The recent downturn in the world economy has caused a decline in U.S.-Mexico trade.

Mexico ranks second among U.S. export markets and is the United States' third-largest trading partner in terms of total trade. In 2009, about 12% of total U.S. merchandise exports were destined for Mexico and 11% of U.S. merchandise imports came from Mexico. The downturn in the U.S. and Mexican economies that resulted from the global financial crisis has resulted in significant decreases in trade between the two countries. U.S. exports to Mexico decreased 19.6% in 2009, while imports from Mexico decreased by 18.5%. For Mexico, the United States is a much more significant trading partner. About 81% of Mexico's exports go to the United States and 48% of Mexico's imports come from the United States. Mexico's second-largest trading partner is China, accounting for approximately 6% of Mexico's exports and imports.<sup>2</sup>

<sup>2</sup> Data compiled by CRS using Global Trade Atlas database.

Although some of the increase in U.S.-Mexico trade since the 1990s could be attributable to NAFTA, there are other variables that affect trade, such as exchange rates and economic conditions. Mexico's currency crisis of 1995 limited the purchasing power of the Mexican people in the years that followed and also made products from Mexico less expensive for the U.S. market. Economic factors such as these played a role in the increasing U.S. trade deficit with Mexico, which went from a \$1.4 billion surplus in 1994 to a \$90.8 billion deficit in 2007. Since then, however, the deficit has fallen to \$70.6 billion in 2009 (see **Figure 1**). U.S. imports from Mexico increased from \$85.0 billion in 1997 to \$216.3 billion in 2008 but then decreased to \$176.3 billion in 2009. U.S. exports to Mexico increased from \$85.0 billion in 1997 to \$216.3 billion in 2008 but then decreased to \$176.3 billion in 2009. U.S. exports to Mexico increased from \$68.4 billion in 1997 to \$131.5 billion in 2008; exports then decreased to \$105.7 billion in 2009.

**Figure 1. U.S. Merchandise Trade with Mexico**  
(US\$ Billions)



**Source:** United States International Trade Commission, Interactive Tariff and Trade Data Web. Compiled by CRS.

Several studies between 2003 and 2004 on the effects of NAFTA found that U.S. trade deficits with Mexico were largely driven by macroeconomic trends, and, in the case of U.S.-Mexico trade, caused by the respective business cycles in Mexico and the United States.<sup>3</sup> Strong U.S. growth in the 1990s, combined with Mexico's deep recession in 1995, were the main factors cited for the large deficits. None of the studies attributed the peso crisis to NAFTA, but to structural misalignments in the Mexican economy combined with political events.<sup>4</sup>

The leading U.S. import item from Mexico in 2009 was oil and gas, which amounted to \$21.16 billion, or 12% of total U.S. imports from Mexico (see **Table 2**). Oil and gas imports from Mexico decreased by 44.2% in 2009. The next leading import items were motor vehicles (\$18.41 billion); audio/video equipment (\$15.63 billion); motor vehicle parts (\$15.35 billion); and communications equipment (\$12.84 billion). All leading imports from Mexico fell in 2009. The leading U.S. export item to Mexico in 2009 was motor vehicle parts, which amounted to \$8.8 billion, or 8% of total exports to Mexico (see **Table 3**). U.S. motor vehicle parts exports to Mexico decreased 12.5% in 2009. The next leading export items were petroleum and coal products (\$6.60 billion); basic chemicals (\$6.17 billion); resin, synthetic rubber and related products (\$4.91 billion); and oilseeds and grains (\$4.17 billion). All leading exports to Mexico decreased markedly in 2009, as shown in **Table 3**.

The immigration issue has received much attention by political leaders in recent years, and it is one that can be linked to the economic situation in Mexico, although it has social and political aspects as well. In March 2008, there were approximately 12 million unauthorized immigrants living in the United States, with 59% from Mexico.<sup>5</sup> Economic conditions in Mexico and other countries, such as poverty and unemployment, are a major factor related to the migration issue. These workers often send money to their families in Mexico to help provide food and shelter.

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<sup>3</sup>See CRS Report RS21737, *NAFTA at Ten: Lessons from Recent Studies*, by J. F. Hornbeck.

<sup>4</sup> *Ibid.*

<sup>5</sup> Pew Hispanic Center, *Trends in Unauthorized Immigration: Undocumented Inflow Now Trails Legal Inflow*, October 2, 2008.

**Table 2. U.S. Imports from Mexico: 2003-2009**  
(US\$ in billions)

Leading Items (NAIC 4-digit)	2003	2004	2005	2006	2007	2008	2009	% Change 2008- 2009
Oil and Gas	13.67	17.23	22.48	29.38	30.27	37.93	21.16	-44.2%
Motor Vehicles	19.03	18.77	18.36	23.24	23.08	22.02	18.41	-16.4%
Audio/Video Equipment	6.91	8.18	9.87	13.89	17.06	17.84	15.63	-12.4%
Motor Vehicle Parts	15.99	17.82	19.33	20.81	22.65	20.58	15.35	-25.4%
Communications Equipment	5.98	7.45	7.34	8.73	13.06	12.99	12.84	-1.2%
Other	75.62	85.51	91.84	101.01	104.04	104.97	92.92	-11.5%
Total	137.20	154.96	169.22	197.06	210.16	216.33	176.31	-18.5

**Source:** Compiled by CRS using USITC Interactive Tariff and Trade DataWeb at <http://dataweb.usitc.gov>: NAIC4-digit level.

**Note:** Nominal U.S. dollars.

**Table 3. U.S. Exports to Mexico: 2003-2009**  
(U.S. \$ in billions)

Leading Items (NAIC 4-digit)	2003	2004	2005	2006	2007	2008	2009	% Change 2007- 2008
Motor Vehicle Parts	7.11	7.55	7.39	8.60	9.40	10.06	8.80	-12.5%
Petroleum and Coal Products	2.31	2.78	4.73	4.98	5.66	9.63	6.60	-31.5%
Basic Chemicals	3.35	4.43	5.01	5.74	6.50	7.16	6.17	-13.8%
Resin, Synthetic Rubber & Related Products	2.94	3.57	4.51	5.37	5.43	5.95	4.91	-17.4%
Oilseeds and Grains	2.61	2.58	2.52	3.05	3.97	5.94	4.17	-29.8%
Other	64.79	72.11	77.51	86.82	88.42	92.77	75.07	-19.08%
Total	83.11	93.02	101.67	114.56	119.38	131.51	105.72	-19.6%

**Source:** Compiled by CRS using USITC Interactive Tariff and Trade DataWeb at <http://dataweb.usitc.gov>: NAIC4-digit level.

**Note:** Nominal U.S. dollars.

## Mexico-U.S. Bilateral Foreign Direct Investment

Foreign direct investment (FDI) has been an integral part of the economic relationship between the United States and Mexico since NAFTA implementation. FDI consists of investments in real estate, manufacturing plants, and retail facilities, in which the foreign investor owns 10% or more of the entity. The United States is the largest source of FDI in Mexico. U.S. FDI on a historical cost basis in Mexico increased from \$17 billion in 1994 to \$95.6 billion in 2008, a 464% increase (see **Table 4**).

Mexican FDI in the United States is much lower than U.S. investment in Mexico, with levels of Mexican FDI fluctuating over the last 10 years. In 2008, Mexican FDI in the United States totaled \$7.6 billion (see **Table 4**).

**Table 4. U.S.- Mexican Foreign Direct Investment Positions:  
1994-2008 Historical Cost Basis**

(U.S. \$ in millions)

Year	Mexican FDI in the U.S.	U.S. FDI in Mexico
1994	2,069	16,968
1995	1,850	16,873
1996	1,641	19,351
1997	3,100	24,050
1998	2,055	26,657
1999	1,999	37,151
2000	7,462	39,352
2001	6,645	52,544
2002	7,483	55,724
2003	6,680	61,526
2004	8,167	63,502
2005	8,653	71,423
2006	6,075	84,699
2007	5,954	91,663
2008	7,592	95,618

**Source:** U.S. Department of Commerce, Bureau of Economic Analysis.

The sharp rise in U.S. investment in Mexico since NAFTA implementation is also a result of the liberalization of Mexico's restrictions on foreign investment in the late 1980s and the early 1990s. Prior to the mid-1980s, Mexico had a very protective policy that restricted foreign investment and controlled the exchange rate to encourage domestic growth, affecting the entire industrial sector. Mexico's trade liberalization measures and economic reform in the late 1980s represented a sharp shift in policy and helped bring in a steady increase of FDI flows into Mexico. NAFTA provisions on foreign investment helped to lock in the reforms and increase investor confidence. Under NAFTA, Mexico gave U.S. and Canadian investors nondiscriminatory treatment of their investments as well as investor protection. NAFTA may have encouraged U.S. FDI in Mexico by increasing investor confidence, but much of the growth may have occurred anyway because

Mexico likely would have continued to liberalize its foreign investment laws with or without the agreement.

Nearly half of total FDI investment in Mexico is in the manufacturing industry of which the maquiladora industry forms a major part. (See “Mexico’s Export-Oriented Assembly Plants” below.) In Mexico, the industry has helped attract investment from countries such as the United States that have a relatively large amount of capital. Therefore, Mexico is able to attract some of the foreign direct investment it was seeking when it liberalized trade and investment barriers. For the United States, the industry is important because U.S. companies are able to locate their labor-intensive operations in Mexico and lower their labor costs in the overall production process. Many economists believe that maquiladoras are an important part of U.S. corporate strategy in achieving competitively priced goods in the world marketplace.<sup>6</sup> Other analysts are concerned that the industry has caused U.S. companies to move their manufacturing facilities to Mexico at the expense of U.S. workers.

## Mexico’s Export-Oriented Assembly Plants

Mexico’s export-oriented assembly plants are closely linked to U.S.-Mexico trade in various labor-intensive industries such as auto parts and electronic goods. These export-oriented plants generate a large amount of trade with the United States and a majority of the plants have U.S. parent companies. Foreign-owned assembly plants, which originated under Mexico’s *maquiladora* program in the 1960s,<sup>7</sup> account for a substantial share of Mexico’s trade with the United States. The border region with the United States has the highest concentration of assembly plants and workers. The Mexican cities with the highest manufacturing activity as of December 2009 were the Mexican border cities of Tijuana, Baja California, 590 plants with 136,957 employees, and Cd. Juárez, Chihuahua, 339 plants with 168,011 employees.<sup>8</sup> Prior to NAFTA, a maquiladora was limited to selling up to 50% of the previous year’s export production to the domestic market. Most maquiladoras export the majority of their production to the U.S. market.

Private industry groups have stated that these operations help U.S. companies remain competitive in the world marketplace by producing goods at competitive prices. In addition, the proximity of Mexico to the United States allows production to have a high degree of U.S. content in the final product, which could help sustain jobs in the United States. Critics of these types of operations argue that they have a negative effect on the economy because they take jobs from the United States and help depress the wages of low-skilled U.S. workers.

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<sup>6</sup> Federal Reserve Bank of Dallas, “The Binational Importance of the Maquiladora Industry,” *Southwest Economy*, Issue 6, November/December 1999.

<sup>7</sup> Mexico’s export-oriented industries began with the maquiladora program established in the 1960s by the Mexican government, which allowed foreign-owned businesses to set up assembly plants in Mexico to produce for export. Maquiladoras could import intermediate materials duty-free with the condition that 20% of the final product be exported. The percentage of sales allowed to the domestic market increased over time as Mexico liberalized its trade regime. U.S. tariff treatment of maquiladora imports played a significant role in the industry. Under HTS provisions 9802.00.60 and 9802.00.80, the portion of an imported good that was of U.S.-origin entered the United States duty-free. Duties were assessed only on the value added abroad. After NAFTA, North American rules of origin determine duty-free status. Recent changes in Mexican regulations on export-oriented industries merged the maquiladora industry and Mexican domestic assembly-for-export plants into one program called the Maquiladora Manufacturing Industry and Export Services (IMMEX).

<sup>8</sup> Data from Mexico’s Instituto Nacional de Estadística y Geografía (INEGI).

Some observers believe that the correlation in maquiladora growth after 1993 is directly due to NAFTA, but in reality it was a combination of factors that contributed to growth. Trade liberalization, wages, and economic conditions, both in the United States and Mexico, all affected the growth of Mexican export-oriented assembly plants. Although some provisions in NAFTA may have encouraged growth in certain sectors, manufacturing activity has been more influenced by the strength of the U.S. economy and relative wages in Mexico.

## **Mexico's Regulations for Manufacturing Plants**

Changes in Mexican regulations on export-oriented industries after NAFTA merged the maquiladora industry and Mexican domestic assembly-for-export plants into one program called the Maquiladora Manufacturing Industry and Export Services (IMMEX). In 2001, the North American rules of origin determined the duty-free status for a given import and replaced the previous special tariff provisions that applied only to maquiladora operations. The initial maquiladora program ceased to exist and the same trade rules applied to all assembly operations in Mexico.

NAFTA rules for the maquiladora industry were implemented in two phases, with the first phase covering the period 1994-2000, and the second phase starting in 2001. During the initial phase, NAFTA regulations continued to allow the maquiladora industry to import products duty-free into Mexico, regardless of the country of origin of the products. This phase also allowed maquiladora operations to increase maquiladora sales into the domestic market. Phase II made a significant change to the industry in that the new North American rules of origin determined duty-free status for U.S. and Canadian products exported to Mexico for maquiladoras. The elimination of duty-free imports by maquiladoras from non-NAFTA countries under NAFTA caused some initial uncertainty for the companies with maquiladora operations. Maquiladoras that were importing from third countries, such as Japan or China, would have to pay applicable tariffs on those goods under the new rules.

Mexico had another program for export-oriented assembly plants called the Program for Temporary Imports to Promote Exports (PITEX) that was established in 1990 to allow qualifying domestic producers to compete with maquiladoras. In 2007, a new set of government regulations on export-oriented industries merged the maquiladora industry and PITEX plants into the Maquiladora Manufacturing Industry and Export Services, or IMMEX. Industry data regarding Mexico's export-oriented assembly plants no longer distinguish maquiladora plants from other Mexican manufacturing plants.<sup>9</sup>

## **Plants and Employment Levels**

The number of maquiladora plants expanded rapidly in the 1990s after NAFTA implementation. Plants increased from 1,920 at the end of 1990 to 3,590 in 2000, and then fell to 2,860 in 2003. Between 2004 and 2007, the last year maquiladoras were classified as such by the Mexican government, the number of plants stayed at approximately the same level, about 2,819.<sup>10</sup> After

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<sup>9</sup> Federal Reserve Bank of Dallas, *Southwest Economy*, Issue 3, "Spotlight: Maquiladora Data, Mexican Reform Clouds View of Key Industry," May/June 2007.

<sup>10</sup> Based on data from INEGI, see <http://www.inegi.org.mx>.

July 2007, the Mexican government published statistics for all manufacturing plants in Mexico under the IMMEX program (which combined maquiladora data with other manufacturing).

The recent downturn in the Mexican economy, combined with the increased violence along the U.S.-Mexico border, has hurt the manufacturing industry, and many IMMEX plants have shut down as a result. In Cd. Juárez, Chihuahua, the city with the highest number of jobs in export assembly plants, IMMEX employment decreased from 214,272 in July 2007 to 168,011 in December 2009, a loss of 46,261 jobs (22% decrease). In Tijuana, Baja California, employment decreased from 174,105 in July 2007 to 136,957 in December 2009, a loss of 37,148 jobs (21% decrease). The total number of IMMEX plants in Mexico increased from 5,083 in July 2007 to 5,245 in December 2009. However, employment decreased from 1,910,112 million in July 2007 to 1,641,465 in December 2009, a loss of 268,647 jobs (14% decrease).<sup>11</sup>

## Worker Remittances to Mexico

Remittances are the second-highest source of foreign currency for Mexico, after oil and tourism. Most worker remittances to Mexico come from workers in the United States who send money back to their relatives in Mexico. Mexico receives the largest amount of remittances in Latin America and the third-largest in the world, after India and China. On January 27, 2010, the *Banco de México*, Mexico's Central Bank, reported that remittance inflows fell 16.0% in 2009 to \$21.1 billion. The decline in remittances is at least partially due to the global financial crisis and the slowdown in the U.S. economy as the rising jobless rate has taken a toll on Mexican immigrants in the United States. Mexico's close economic ties to the United States, particularly in the housing and services sectors, which have both been negatively affected by the financial crisis, contributed to the decline. Approximately 239,000 immigrant Hispanics lost their jobs in 2008, with almost 100,000 of these jobs in the construction industry, according to one estimate.<sup>12</sup>

For a number of years, remittances were considered a stable financial flow for Mexico as workers in the United States made efforts to send money to family members, especially to regions of the country experiencing economic crises or natural disasters. Annual remittances to Mexico grew substantially between 2001 and 2008, from \$8.9 billion to \$25.1 billion, an increase of 182.0%. The annual growth rate reached a high of 26.3% in 2003, then continued at a slower rate until 2009 (see **Table 5**). There is an interrelationship between remittances to Mexico and economic growth in the United States, such as 2004 and 2005, in which the U.S. economy grew by 3.6% and 3.1%, respectively, but not much is known about the extent of this relationship.<sup>13</sup> Although the relationship between GDP growth and the level of remittances is not very clear, the Mexican government attributes the 2009 decline to the global financial crisis.<sup>14</sup>

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<sup>11</sup> Ibid.

<sup>12</sup> *The Wall Street Journal*, "Remittances to Mexico Fall More than Forecast," p. A3, January 28, 2009.

<sup>13</sup> Migration Policy Institute, *Migration Facts*, "Variable Impacts: State-level Analysis of the Slowdown in the Growth of Remittances to Mexico," September 2007.

<sup>14</sup> Associated Press, "Mexico Sees Record 15.7 percent Annual Drop in Money Sent Home by Migrants," January 27, 2010.

**Table 5. Percent Changes in Remittances to Mexico**

US\$ Billions

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Amount	8.9	10.5	13.3	16.6	20.0	23.7	24.0	25.1	21.1
% Change	—	18.5%	26.3%	25.2%	20.6%	18.5%	1.0%	4.9%	-16.0%

**Source:** Compiled by CRS using data from the Inter-American Development Bank, The Multilateral Investment Fund.

Worker remittance flows to Mexico have an important impact on the Mexican economy, in some regions more than others. Some studies on remittance flows to Mexico report that in southern Mexican states, remittances mostly or completely cover general consumption and/or housing. One study estimates that 80% of the money received by households goes for food, clothing, health care, and other household expenses. Another study estimates that remittances in Mexico are responsible for about 27%, and up to 40% in some cases, of the capital invested in microenterprises throughout urban Mexico.<sup>15</sup> The economic impact of remittance flows is concentrated in the poorer states of Mexico. The government has sponsored programs to channel the funds directly to infrastructure and investment rather than consumption.<sup>16</sup>

## Security and Prosperity Partnership of North America

The Security and Prosperity Partnership of North America (SPP) was a trilateral initiative that was launched in March 2005 by Canada, Mexico, and the United States to increase cooperation and information sharing for the purpose of increasing and enhancing security and prosperity in North America. It is unclear what course of action will be taken under President Barack Obama's Administration with regard to the former SPP initiatives. The U.S. government website on the SPP states that the website has been archived and will not be updated. President Obama met with Mexican President Calderón and Canadian Prime Minister Harper at the North American Leaders' Summit in Guadalajara, Mexico, in August 2009 to discuss key issues that affect the three countries. They agreed to continue cooperation in these areas, but there was no mention of continuing the SPP.

The SPP was a government initiative that was endorsed by Canada, Mexico, and the United States between 2005 and 2008, but it was not a signed agreement or treaty and, therefore, contained no legally binding commitments or obligations. It could, at best, be characterized as an endeavor by the three countries to facilitate communication and cooperation across several key policy areas of mutual interest. Although the SPP built upon the existing trade and economic relationship of the three countries, it was not a trade agreement and distinct from the existing North American Free Trade Agreement (NAFTA). Some key issues for Congress regarding the SPP concerned possible implications related to private sector priorities, national sovereignty, transportation corridors, cargo security, and border security.

<sup>15</sup> The Federal Reserve Bank of Dallas report "Workers' Remittances to Mexico," (2004) evaluated the economic impact of worker remittances to Mexico and cites a number of reports by the World Bank and the Mexican government.

<sup>16</sup> Ibid, p. 4.

The SPP established a number of working groups related to both the security and prosperity components of the initiative. The security working groups were chaired by the Secretary of Homeland Security and the prosperity working groups were chaired by the Secretary of Commerce. In 2005 and 2006, the SPP working groups provided annual reports to the three North American leaders on their work and key accomplishments. The 2005 report provided the initial proposals on how to accomplish the goals of the SPP. The priorities focused on increasing collaborative efforts to improve certain sectors of the economy; developing higher standards of safety and health; and addressing environmental concerns.

At the 2007 North American Leaders' Summit in Montebello, Canada, the leaders announced the following priorities for the SPP: (1) Enhancement of the Global Competitiveness of North America, (2) Safe Food and Products, (3) Sustainable Energy and the Environment, (4) Smart and Secure Borders, and (5) Emergency Management and Preparedness. In February 2008, ministers from the United States, Canada, and Mexico met in Baja California, Mexico, to review the progress of the working groups during the previous year and to discuss cooperative approaches for meeting challenges and opportunities in the five SPP priority areas. In April 2008, the North American leaders held a summit to discuss how they might further advance the goals of the SPP. The three leaders decided that their respective ministers should continue to renew and focus their work in the five SPP priority areas.

Some observers saw the SPP as an important step forward in the relationship of the United States with Mexico, and also Canada, in view of the distancing that occurred after the terrorist attacks of September 11, 2001.<sup>17</sup> However, other analysts believed that the SPP and any subsequent trade-facilitating measures fell short of any grander vision of further economic integration.<sup>18</sup> Critics of the SPP contended that it would ultimately lead to a so-called "NAFTA Superhighway" that would link the United States, Canada, and Mexico with a "super-corridor."<sup>19</sup> However, if the United States were to potentially consider the formation of a customs union or common market with its North American neighbors, it would require approval by the U.S. Congress.

## The Mexican Economy

Mexico has a free market economy with a strong export sector, but this has not always been the case. The transformation of Mexico into an export-based economy began in the late 1980s when the government started to liberalize its trade policy and adopt economic reform measures. The Mexican economy is highly sensitive to economic developments in the United States because of its dependence on the United States as an export market. The state of the Mexican economy is also important to the United States, because of the close trade and investment ties between the two countries, and because of other social and political issues that could be affected by economic conditions, particularly those related to social stability and immigration.

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<sup>17</sup> "U.S., Mexico, Canada Agree to Increase Cooperation," *The Washington Post*, March 24, 2005, p. A4.

<sup>18</sup> "Neighbors Who Are not Always Friends: Bush's Summit with Mexican and Canadian Leaders Will Probably Take Small Steps Toward Bolder Integration," *The Christian Science Monitor*, March 23, 2005, p. 2.

<sup>19</sup> See for example, Corsi, Jerome R., *The Plan to Replace the Dollar with the 'Amero'*, May 22, 2006; Corsi, Jerome, *I-69: Yet Another NAFTA Superhighway*, September 12, 2006; or Schlafly, Phyllis, *The NAFTA Superhighway*, August 23, 2006.

## History of Economic Reforms

In the late 1980s and early into the 1990s, the Mexican government implemented a series of measures to restructure the economy that included steps toward trade liberalization. For many years, Mexico had protectionist trade policies to encourage industrial growth in the domestic economy, but the policies did not have the expected positive results on industrial growth. The 1980s in Mexico were marked by inflation and a declining standard of living. After the 1982 debt crisis in which the Mexican government was unable to meet its foreign debt obligations, the country began experiencing a number of economic challenges. Much of the government's effort in addressing the challenges was placed on privatizing state industries and moving toward trade liberalization. Efforts included privatization of sea ports, railroads, telecommunications, electricity, natural gas distribution and airports. The negotiation and implementation of NAFTA played a major role in Mexico's changing economic policy in the early 1990s.

Mexico's economic reforms initially attracted a large amount of private foreign investment, but by 1993 the inflow of foreign capital began to slow down. By the end of 1994, Mexico faced a currency crisis, putting pressure on the government to abandon its previous fixed exchange rate policy and adopt a floating exchange rate regime. As a result, Mexico's currency plunged by around 50% within six months, sending the country into a deep recession.<sup>20</sup> Several factors influenced the decision to float the peso: overspending in the economy had generated a significant current account deficit; the Mexican government had accumulated large levels of debt with insufficient reserves; and the banking system was facing a crisis due to overexposure.<sup>21</sup> Mexico's finance minister at the time, Guillermo Ortiz, stated later that Mexico had "no choice" but to float the peso because the government had run out of reserves.<sup>22</sup>

In the aftermath of the 1994 devaluation, Mexican President Ernesto Zedillo took several steps to restructure the economy and lessen the impact of the currency crisis among the more disadvantaged sectors of the economy. The goal was to create conditions for economic activity so that the economy could adjust in the shortest time possible. The United States and the IMF assisted the Mexican government by putting together an emergency financial support package of up to \$50 billion, with most of the money coming from the U.S. Treasury. The Zedillo Administration wanted to demonstrate its commitment to fulfill all its financial obligations without a default on its debt by adopting tight monetary and fiscal policies to reduce inflation and absorb some of the costs of the banking sector crisis. The austerity plan included an increase in the value-added tax, budget cuts, increases in electricity and gasoline prices to decrease demand and government subsidies, and tighter monetary policy.<sup>23</sup>

Following the lead of former President Ernesto Zedillo, former President Vicente Fox continued efforts to liberalize trade, privatize government enterprises, and deregulate the economy. Through tighter monetary and fiscal policies, the Fox Administration was able to decrease the fiscal deficit, control inflation, and help economic growth.

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<sup>20</sup> EIU, "Mexico Finance: The Peso Crisis, Ten Years On," January 3, 2005.

<sup>21</sup> Banco de Mexico, "Mexico's Monetary Policy Framework Under a Floating Exchange Rate Regime," by Agustín G. Carstens y Alejandro M. Werner, May 1999.

<sup>22</sup> EIU, "Mexico Economy: Mexico Begins to See Benefits of Free-Floating Peso," December 20, 2004.

<sup>23</sup> Joachim Zietz, "Why Did the Peso Collapse? Implications for American Trade," *Global Commerce*, by , Volume 1, No. 1, Summer 1995.

The peso steadily depreciated through the end of the 1990s, which led to greater exports and helped the country's exporting industries. However, the peso devaluation also resulted in a decline in real income, hurting the poorest segments of the population and also the newly emerging middle class. NAFTA and the change in the Mexican economy to an export-based economy helped to soften the impact of the currency devaluation.

After a real decline in GDP of 6.22% in 1995, the Mexican economy managed to grow 5%-6% in each of the three years to 1998. The combination of a stronger peso and the slowdown in the U.S. economy in 2001, which worsened after the September 11 terrorist attacks, hit Mexico's economy hard. Real GDP growth dropped from 6.2% in 2000 to -0.16% in 2001. Improving economic conditions in the United States helped Mexico's economy improve as well. Real GDP growth in 2004 was 4.37%, up from 1.41% in 2003 and 0.81% in 2002 (see **Figure 2**). Real GDP went from a 4.8% growth rate in 2006 to a contraction of 6.9% in 2009.

## Effects of the Global Financial Crisis

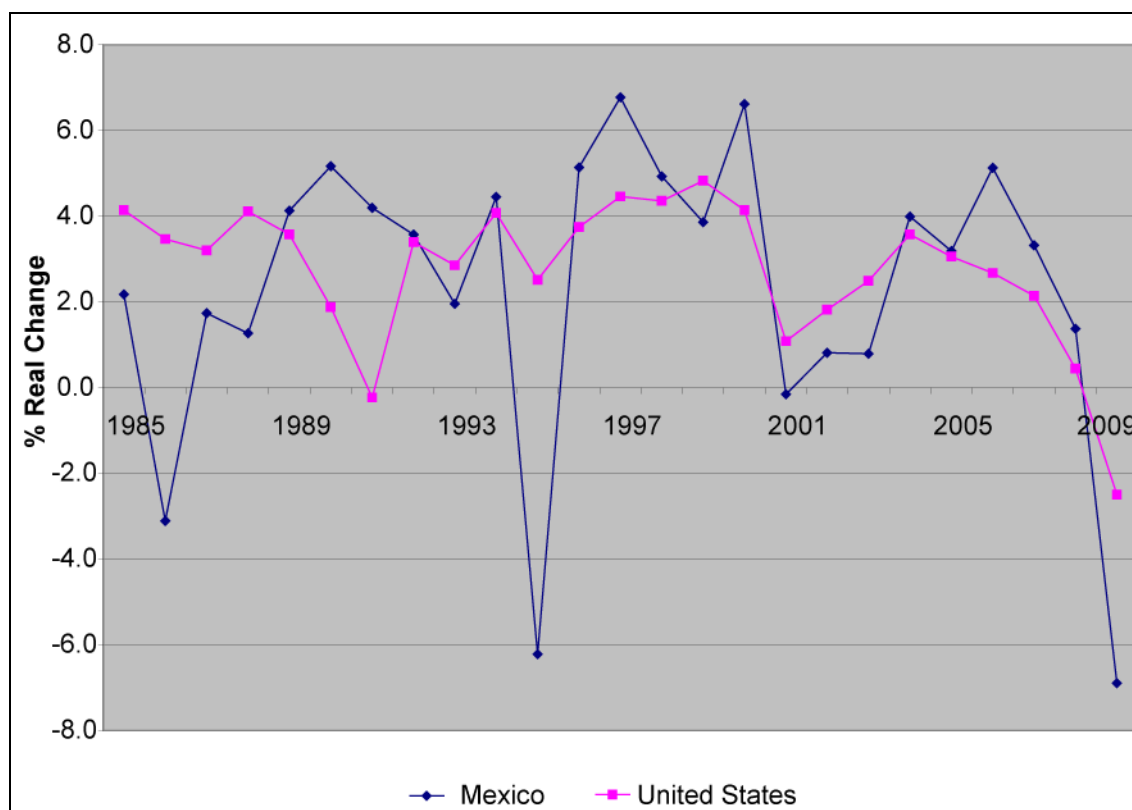
The global financial crisis, along with downturn in the U.S. economy, resulted in the deepest recession in the Mexican economy since the 1930s. The economy contracted by 6.9% in 2009, while the peso fell 25% against the dollar in the first nine months of 2009.<sup>24</sup> Reflecting its ties to the U.S. market, Mexico's total exports and imports decreased by more than 20%. Mexico also experienced liquidity problems and a loss in investor confidence as a result of large losses on corporate foreign exchange positions in 2008, in addition to the uncertainty over the outbreak of the H1N1 virus in mid-2009.<sup>25</sup> Mexico's financial markets have stabilized since the global financial crisis began in late 2008. Estimates for 2010 project that the economy will grow by about 3% to 4% and that domestic demand will also improve. The exchange rate has stabilized but the peso is expected to continue a gradual weakening throughout 2010 which will likely provide support in all of Mexico's export sectors.<sup>26</sup>

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<sup>24</sup> International Monetary Fund (IMF), *Public Information Notice*, "IMF Executive Board Concludes 2010 Article IV Consultation with Mexico," March 16, 2010, p. 2.

<sup>25</sup> Ibid.

<sup>26</sup> EIU, *Country Report: Mexico*, March 2010.

**Figure 2. GDP Growth Rates for the United States and Mexico**

Source: Economist Intelligence Unit.

Mexico experienced the deepest recession in the Latin America region following the crisis. This is largely due to its high dependence on manufacturing exports and its ties to the U.S. economy, though other factors have also contributed. Other Latin American countries have experienced negative economic consequences from the global financial crisis, but to a lesser extent. In Central America, the economy of Honduras was the most affected, with a contraction of 4.4%. Economic growth in most South American countries was affected by the crisis, but because most of these countries were experiencing high levels of growth prior to the crisis, the effect was not as severe. Paraguay was the country most adversely affected in South America, with a -3.8% change in real GDP.

President Calderón of Mexico has implemented a number of measures to help cushion the Mexican economy from the fallout of the global economic crisis and the onset of recession in the United States. Mexico's policy measures in response to the crisis and its prior economic performance have helped the economy begin to recover and the exchange rate to improve.<sup>27</sup> Mexico's Central Bank made substantial interventions to stabilize conditions in the foreign exchange market and secured lines of credit through the U.S. Federal Reserve swap line and the International Monetary Fund (IMF) to improve confidence in the economy. The IMF set up flexible credit lines to help countries deal with the effects of the global recession and provided a credit line of \$48 billion for Mexico in 2009, which was set to expire in April 2010. The IMF renewed the \$48 billion credit line for Mexico on March 25, 2010, to protect against possible

<sup>27</sup> International Monetary Fund (IMF), *Public Information Notice*, March 16, 2010, p. 2.

market turmoil.<sup>28</sup> Mexico has indicated that it does not intend to draw on the resources, but sought the renewal to provide confidence to investors and financial markets in the event that global conditions were to deteriorate.<sup>29</sup>

The Mexican government has also taken a series of measures to strengthen the economy. The FY2010 budget included a substantive tax reform that was designed to offset the revenue losses from lower oil production. Mexico's requirements on corporate disclosure of derivative exposures have been tightened. In addition the government has made structural reforms to enhance growth potential, most recently in the electricity sector, and announced plans to gradually increase foreign exchange reserves.<sup>30</sup> However, Mexico's dependence on falling oil revenues and weak prospects for reforming the oil industry may continue its vulnerability to future external shocks.<sup>31</sup>

## Poverty in Mexico

Poverty is one of the more serious and pressing economic problems facing Mexico. The Mexican government had made progress in its poverty reduction efforts, but poverty continues to be a basic challenge for the country's development. The authors of a World Bank study note that poverty is often associated with social exclusion, especially of indigenous groups of people who comprise 20% of those who live in extreme poverty.<sup>32</sup> In 2002, over half of the population lived in poverty. According to World Bank estimates, the percentage of people living in extreme poverty, or on less than \$1 per day, fell from 24.2% of the population in 2000, to 20.3% in 2002, and 18% in 2005. Those living in moderate poverty, or on about \$10 a day, fell from 53.7% in 2000 to 51.7% of the population in 2002 and 45% in 2005. Mexico's continuing problem of poverty is especially widespread in rural areas and remains at the Latin American average.<sup>33</sup>

The alleviation of poverty has been a high priority for the Mexican government. Mexico's main program to reduce the effects of poverty is the *Oportunidades* program (formerly known as Progresa). The program seeks to not only alleviate the immediate effects of poverty through cash and in-kind transfers, but to break the cycle of poverty by improving nutrition and health standards among poor families and increasing educational attainment. This program provides cash transfers to families in poverty who demonstrate that they regularly attend medical appointments and can certify that children are attending school. The government provides educational cash transfers to participating families. The program also provides nutrition support to pregnant and nursing woman and malnourished children. Monthly benefits are a minimum of \$15 with a cap of about \$150. The majority of households receiving *Oportunidades* benefits are in Mexico's six poorest states: Chiapas, Mexico State, Puebla, Veracruz, Oaxaca, and Guerrero.<sup>34</sup>

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<sup>28</sup> *Reuters News*, "IMF Renews \$48 billion Credit Line for Mexico," March 25, 2010.

<sup>29</sup> International Monetary Fund (IMF) *Survey Magazine: In the News*, "Mexico Recovering, but Crisis Spotlights Challenges," says IMF," March 16, 2010.

<sup>30</sup> IMF, *Public Information Notice*, March 16, 2010, p. 2.

<sup>31</sup> EIU, *Country Report: Mexico*, March 2010.

<sup>32</sup> The World Bank Group Press Release, "Mexico Makes Progress and Faces Challenges in Poverty Reduction Efforts," July 2004.

<sup>33</sup> *Ibid.*

<sup>34</sup> Santiago Levy, *Progress Against Poverty*, Brookings Institution, 2006.

## Mexico's Regional Free Trade Agreements

Since the early 1990s, Mexico has had a growing commitment to trade liberalization, and its trade policy is among the most open in the world. Mexico has pursued free trade agreements (FTAs) with other countries as a way to bring benefits to the economy and also to reduce its economic dependence on the United States. By early 2006, Mexico had entered into a total of 12 FTAs involving 42 countries. The Mexican government has negotiated bilateral or multilateral trade agreements with most countries in the Western Hemisphere, including the United States and Canada, Chile, Bolivia, Costa Rica, Nicaragua, Uruguay, Colombia, Guatemala, El Salvador, and Honduras.<sup>35</sup>

Mexico has ventured out of the hemisphere in negotiating FTAs, and, in July 2000, entered into agreements with Israel and the European Union. Mexico became the first Latin American country to have preferred access to these two markets. Mexico has also completed an FTA with the European Free Trade Association (EFTA) of Iceland, Liechtenstein, Norway, and Switzerland. The Mexican government has continued to look for potential free trade partners, and expanded its outreach to Asia in 2000 by entering into negotiations with Singapore, Korea and Japan.<sup>36</sup> In 2004, Japan and Mexico signed an Economic Partnership Agreement. It was the first comprehensive trade agreement that Japan signed with any country.<sup>37</sup> Mexico's negotiations on FTAs with Korea and Singapore are stalled.

In addition to the bilateral and multilateral free trade agreements, Mexico is a member of the WTO,<sup>38</sup> the Asia-Pacific Economic Cooperation forum, and the OECD.<sup>39</sup> In September 2003, Mexico hosted the WTO Ministerial Meeting in Cancun.

## NAFTA and the U.S.-Mexico Economic Relationship

The North American Free Trade Agreement (NAFTA) has been in effect since January 1994. There are numerous indications that NAFTA has achieved many of the intended trade and economic benefits as well as incurred adjustment costs. This has been in keeping with what most economists maintain, that trade liberalization promotes overall economic growth among trading partners, but that there are significant adjustment costs.

Most of the trade effects in the United States related to NAFTA are due to changes in U.S. trade and investment patterns with Mexico. At the time of NAFTA implementation, the U.S.-Canada Free Trade Agreement already had been in effect for five years, and some industries in the United

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<sup>35</sup> Organization of American States, Foreign Trade Information System (SICE), see <http://www.sice.oas.org>.

<sup>36</sup> *The Asahi Shimbun*, "Mexico: Loving Free Trade Ever Since NAFTA," March 2002. See <http://www.facilitycity.com>.

<sup>37</sup> *The Asahi Shimbun*, "Japan: Free Trade with Mexico," *The Asahi Shimbun*, March 12, 2004.

<sup>38</sup> The WTO allows member countries to form regional trade agreements, but under strict rules. The position of the WTO is that regional trade agreements can often support the WTO's multilateral trading system by allowing groups of countries to negotiate rules and commitments that go beyond what was possible at the time under the WTO. The WTO has a committee on regional trade agreements that examines regional groups and assesses whether they are consistent with WTO rules. See The World Trade Organization, "Understanding the WTO: Cross-Cutting and New Issues, Regionalism: Friends or Rivals?" <http://www.wto.org>.

<sup>39</sup> U.S. Commercial Service, *Country Commercial Guide: Mexico*, August 13, 2004, p. 6.

States and Canada were already highly integrated. Mexico, on the other hand, had followed an aggressive import-substitution policy for many years prior to NAFTA in which it had sought to develop certain domestic industries through trade protection. One example is the Mexican automotive industry, which had been regulated by a series of five decrees issued by the Mexican government between 1962 and 1989. The decrees established import tariffs as high as 25% on automotive goods and had high restrictions on foreign auto production in Mexico. Under NAFTA, Mexico agreed to eliminate these restrictive trade policies.

Not all changes in trade and investment patterns between the United States and Mexico since 1994 can be attributed to NAFTA because trade was also affected by other unrelated economic factors such as economic growth in the United States and Mexico, and currency fluctuations. Also, trade-related job gains and losses since NAFTA may have accelerated trends that were ongoing prior to NAFTA and may not be totally attributable to the trade agreement. Overall, Mexico has experienced a slight shift in the composition of trade with the United States since the late 1980s from oil to non-oil exports. In 1987, crude oil and natural gas comprised 17% of Mexico's exports to the United States. The percentage of oil and natural gas exports had declined to 11% in 2004, increased to 14% in 2007 due to higher oil prices, and went back down to 12% in 2009.

## **Effects on the U.S. Economy**

The overall effect of NAFTA on the U.S. economy has been relatively small, primarily because two-way trade with Mexico amounts to less than 3% of U.S. GDP. Thus, any changes in trade patterns with Mexico would not be expected to be significant in relation to the overall U.S. economy. In some sectors, however, trade-related effects could be more significant, especially in those industries that were more exposed to the removal of tariff and non-tariff trade barriers, such as the textile and apparel, and automotive industries.

Since NAFTA, the automotive, textile, and apparel industries have experienced some of the more noteworthy changes in trading patterns, which may also have affected U.S. employment in these industries. U.S. trade with Mexico has increased considerably more than U.S. trade with other countries, and Mexico has become a more significant trading partner with the United States since NAFTA implementation.

In the automotive industry, the industry comprising the most U.S. trade with Mexico, NAFTA provisions consisted of a phased elimination of tariffs, the gradual removal of many non-tariff barriers to trade including rules of origin provisions, enhanced protection of intellectual property rights, less restrictive government procurement practices, and the elimination of performance requirements on investors from other NAFTA countries. These provisions may have accelerated the ongoing trade patterns between the United States and Mexico. Because the United States and Canada were already highly integrated, most of the trade impacts on the U.S. automotive industry relate to trade liberalization with Mexico. Prior to NAFTA Mexico had a series of government decrees protecting the domestic auto sector by reserving the domestic automobile market for domestically produced parts and vehicles. NAFTA established the removal of Mexico's restrictive trade and investment policies and the elimination of U.S. tariffs on autos and auto parts. By 2006, the automotive industry has had the highest dollar increase (\$41 billion) in total U.S. trade with Mexico since NAFTA passage.

The main NAFTA provisions related to textiles and apparel consisted of eliminating tariffs and quotas for goods coming from Mexico and eliminating Mexican tariffs on U.S. textile and apparel

products. To benefit from the free trade provision, goods were required to meet the rules of origin provision which assured that apparel products that were traded among the three NAFTA partners were made of yarn and fabric made within the free trade area. The strict rules of origin provisions were meant to ensure that U.S. textiles producers would continue to supply U.S. apparel companies that moved to Mexico. Without a rules of origin provision, apparel companies would have been able to import low-cost fabrics from countries such as China and export the final product to the United States under the free trade provision.<sup>40</sup>

While some U.S. industries may have benefitted from increased demand for U.S. products in Mexico, creating new jobs, other industries have experienced job losses. Data on the effects of trade liberalization with Mexico are limited and the effect on specific sectors of the U.S. economy is difficult to quantify. Trade-related job gains and losses since NAFTA may have accelerated trends that were ongoing prior to NAFTA and may not be totally attributable to the trade agreement.<sup>41</sup> Quantifying these effects is challenging because of the other economic factors that influence trade and employment levels. The devaluation of the Mexican peso in 1995 resulted in lower Mexican wages, which likely provided an incentive for U.S. companies to move to lower their production costs. Trade-related employment effects following NAFTA could have also resulted from the lowering of trade barriers, and from the economic conditions in Mexico and the United States influencing investment decisions and the demand for goods.

## Effects on the Mexican Economy

A number of studies have found that NAFTA has brought economic and social benefits to the Mexican economy as a whole, but that the benefits have not been evenly distributed throughout the country. Most studies after NAFTA have found that the effects on the Mexican economy tended to be modest at most.<sup>42</sup> While there have been periods of positive growth and negative growth in Mexico after the agreement was implemented, much of the increase in trade began in the late 1980s when the country began trade liberalization measures. Though its net economic effects may have been positive, NAFTA itself has not been enough to lower income disparities within Mexico, or between Mexico and the United States or Canada.

A 2005 World Bank study assessing some of the economic impacts from NAFTA on Mexico concluded that NAFTA helped Mexico get closer to the levels of development in the United States and Canada. The study states that NAFTA helped Mexican manufacturers to adopt to U.S. technological innovations more quickly and likely had positive impacts on the number and quality of jobs. Another finding was that since NAFTA went into effect, the overall macroeconomic volatility, or wide variations in the GDP growth rate, has declined in Mexico. Business cycles in Mexico, the United States, and Canada have had higher levels of synchronicity since NAFTA, and NAFTA has reinforced the high sensitivity of Mexican economic sectors to economic developments in the United States.<sup>43</sup>

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<sup>40</sup> For more information on textile and apparel trade, see CRS Report RL31723, *Textile and Apparel Trade Issues*, by Bernard A. Gelb.

<sup>41</sup> CRS Report 98-783, *NAFTA: Estimates of Job Effects and Industry Trade Trends After 5 1/2 Years*, by Mary Jane Bolle.

<sup>42</sup> For more information, see CRS Report RS21737, *NAFTA at Ten: Lessons from Recent Studies*, by J. F. Hornbeck.

<sup>43</sup> The World Bank, *Lessons from NAFTA for Latin America and the Caribbean*, by Daniel Lederman, William F. Maloney, and Luis Servén, 2005. (Hereinafter *Lessons from NAFTA*, 2005).

Several economists have noted that it is likely that NAFTA contributed to Mexico's economic recovery directly and indirectly after the 1995 currency crisis. Mexico responded to the crisis by implementing a strong economic adjustment program but also by fully adhering to its NAFTA obligations to liberalize trade with the United States and Canada. NAFTA may have supported the resolve of the Mexican government to continue with the course of market-based economic reforms, resulting in increasing investor confidence in Mexico. The World Bank study estimates that FDI in Mexico would have been approximately 40% lower without NAFTA.<sup>44</sup>

One of the main arguments in favor of NAFTA at the time it was being proposed by policymakers was that the agreement would improve economic conditions in Mexico and narrow the income gap between Mexico and the United States. Studies that have addressed the issue of economic convergence<sup>45</sup> have noted that economic convergence in North America might not materialize under free trade as long as "fundamental differences" in initial conditions persist over time. One study argues that NAFTA is not enough to help narrow the disparities in economic conditions between Mexico and the United States and that Mexico needs to invest more in education; innovation and infrastructure; and in the quality of national institutions. The study states that income convergence between a Latin American country and the United States is limited by the wide differences in the quality of domestic institutions, in the innovation dynamics of domestic firms, and in the skills of the labor force.<sup>46</sup> Another study also notes that the ability of Mexico to improve economic conditions depends on its capacity to improve its national institutions, adding that Mexican institutions did not improve significantly more than those of other Latin American countries during the post-NAFTA period.<sup>47</sup>

Mexican wages rose steadily from the early 1980s until the mid-1990s, when the currency crisis hit. After a drop in average real wages in 1996 of 15.5%, real wages increased steadily until 2000, when the average rate of growth was 11.8%. Since then the average rate of growth has only varied slightly (see **Figure 2**). Mexico's trade liberalization measures may have affected the ratio between skilled and non-skilled workers in Mexico. In 1988, the real average wage of skilled workers in Mexico's manufacturing industry was 2.25 times larger than that of non-skilled workers. This ratio increased until 1996, when it was about 2.9, but then remained stable until 2000.<sup>48</sup> The World Bank study found that NAFTA brought economic and social benefits to the Mexican economy, but that the agreement in itself was not sufficient to ensure a narrowing of the wage gap between Mexico and the United States. The study states that NAFTA had a positive effect on wages and employment in some Mexican states, but that the wage differential within the country increased as a result of trade liberalization.<sup>49</sup>

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<sup>44</sup> Ibid.

<sup>45</sup> Economic convergence can be broadly defined as a narrowing of the disparities in the economic levels and the manufacturing performances of particular countries or their regions. The goal of the theory of economic convergence is to research and analyze the factors influencing the rates of economic growth and real per capita income in countries.

<sup>46</sup> *Lessons from NAFTA*, 2005.

<sup>47</sup> *Economia*, "NAFTA and Convergence in North America: High Expectations, Big Events, Little Time," by William Easterly, Norbert Fiess, and Daniel Lederman, Fall 2003.

<sup>48</sup> Esquivel, Gerardo, and José Antonio Rodríguez-López, "Technology, trade, and wage inequality in Mexico before and after NAFTA," *Journal of Development Economics*, 2003.

<sup>49</sup> *Lessons from NAFTA*, 2005.

## Major Issues in U.S.-Mexico Trade Relations

Major trade disputes between Mexico and the United States since NAFTA have involved the access of Mexican trucks to the United States; the access of Mexican sugar and tuna to the U.S. market; and the access of U.S. sweeteners to the Mexican market.

### Mexico Trucking Issue

A major U.S.-Mexico trade issue relates to the implementation of NAFTA trucking provisions. Under NAFTA, Mexican commercial trucks were to have been given full access to four U.S. border states in 1995 and full access throughout the United States in 2000. Citing safety concerns, however, the United States refused implementation of NAFTA's trucking provisions and the Mexican government objected. A NAFTA dispute resolution panel supported Mexico's position in February 2001. President Bush indicated a willingness to implement the provision, but the U.S. Congress required additional safety provisions in the FY2002 Department of Transportation Appropriations Act (P.L. 107-87).

On November 27, 2002, with safety inspectors and procedures in place, the Bush Administration announced that it would begin the process that would open U.S. highways to Mexican truckers and buses but environmental and labor groups went to court in early December to block the action. On January 16, 2003, the U.S. Court of Appeals for the Ninth Circuit ruled that full environmental impact statements were required before Mexican trucks would be allowed to operate on U.S. highways, but the U.S. Supreme Court reversed that decision on June 7, 2004.

Since the ruling, the United States and Mexico have worked on resolving the trucking issues, and the two countries have engaged in numerous talks regarding a number of safety and operational issues. The Obama Administration has indicated it intends to propose a revamped Mexican truck pilot program that began under the Bush Administration. At a hearing of the Senate Appropriations Transportation Subcommittee on March 4, 2010, DOT Secretary Ray LaHood stated that the Obama Administration was close to finalizing a plan to resolve the truck dispute.<sup>50</sup>

A truck safety statistic on "out-of-service" rates indicates that Mexican trucks operating in the United States are now safer than they were a decade ago. The data indicate that Mexican trucks and drivers have a comparable safety record to U.S. truckers. Another study indicates that the truck driver is usually the more critical factor in causing accidents than a safety defect with the truck itself. Service characteristics of long-haul trucking suggest that substandard carriers would likely not succeed in this market.<sup>51</sup>

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<sup>50</sup> Bureau of National Affairs, *International Trade Reporter*, "Plan to Resolve Mexican Trucking Dispute 'Very Near,' DOT's LaHood Tells Lawmakers," March 11, 2010.

<sup>51</sup> See CRS Report RL31738, *North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border*, by John Frittelli, *North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border*, by John Frittelli.

## **Mexican Truck Pilot Program**

In February 2007, the Bush Administration announced a pilot project to grant Mexican trucks from 100 transportation companies full access to U.S. highways. The Bush Administration announced a delay in the program in April 2007, likely in response to critics who contended that Mexican trucks do not meet U.S. standards. The Iraq War Supplemental (P.L. 110-28), enacted May 25, 2007, mandated that any pilot program to give Mexican trucks access beyond the border region could not begin until U.S. trucks had similar access to Mexico. In addition, the Department of Transportation (DOT) was required to meet certain reporting and public notice requirements before any pilot program could begin. The DOT's Inspector General had to prepare a report to Congress to verify that the DOT had established mechanisms to ensure that Mexican truck comply with U.S. federal motor carrier safety laws. The report was required to verify that Mexican trucks meet the safety provisions of P.L. 107-87, mentioned above.

By September 2007, the DOT launched the one-year pilot program to allow approved Mexican carriers beyond the 25-mile commercial zone, with a similar program allowing U.S. trucks to travel beyond Mexico's commercial zone. As of early January 2008, 57 trucks from 10 Mexican companies had received permission to operate in the United States and 41 trucks from four U.S. companies received permission to operate in Mexico. DOT data reportedly showed that U.S. carriers had made twice as many trips to Mexico as Mexican carriers have to the United States from the time the program was launched until early January 2008.

In the FY2008 Consolidated Appropriations Act (P.L. 110-161), signed into law in December 2007, Congress included a provision prohibiting the use of FY2008 funding for the establishment of a pilot program. However, the DOT determined that it could continue with the pilot program because it had already been established. In March 2008, the DOT issued an interim report on the cross-border trucking demonstration project to the Senate Committee on Commerce, Science, and Transportation. The report made three key observations: (1) the Federal Motor Carrier Safety Administration (FMCSA) planned to check every participating truck each time it crossed the border to ensure that it met safety standards; (2) there was less participation in the project than was expected; and (3) the FMCSA implemented methods to assess possible adverse safety impacts of the project and to enforce and monitor safety guidelines.<sup>52</sup>

In early August 2008, the DOT announced that it would be extending the pilot program for an additional two years. On September 9, 2008, the House approved (by a vote of 396 to 128) H.R. 6630, a bill that would prohibit the Department of Transportation from granting Mexican trucks access to U.S. highways beyond the border and commercial zone. The bill would also prohibit the Department of Transportation from renewing such a program unless expressly authorized by Congress. No action was taken by the Senate on the measure.

The FY2009 Omnibus Appropriations Act (P.L. 111-8) terminated the pilot program that began in September 2007. On April 2, 2009, a trade association representing carriers in Mexico's trucking industry filed a notice of arbitration under the investment chapter (Chapter 11) of NAFTA. The notice of arbitration alleges that the U.S. Department of Transportation restricts Mexican carrier operations in the United States and Mexican investment in U.S. carriers, which is in violation of

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<sup>52</sup> Department of Transportation. "Cross-Border Trucking Demonstration Project," March 11, 2008.

NAFTA Articles 1102 and 1103. It also charges that the United States has failed to comply with a 2001 ruling by a NAFTA dispute resolution panel.<sup>53</sup>

The FY2010 Consolidated Appropriations Act passed in December 2009 (P.L. 111-117) did not preclude funds from being spent on a long-haul Mexican truck pilot program, provided that certain terms and conditions were satisfied.<sup>54</sup>

### **Mexico's Retaliatory Tariffs and Efforts in the United States to Resolve the Issue**

In response to the abrupt end of the pilot program, the Mexican government announced that it would retaliate by increasing duties on 90 U.S. products with an import value of \$2.4 billion. The tariffs, effective as of March 19, 2009, range from 10% to 45% and cover a range of products that include fruit, vegetables, home appliances, consumer products, and paper.<sup>55</sup> In March 2010, a group of 56 Members of the House of Representatives wrote to United States Trade Representative Ron Kirk and DOT Secretary Ray LaHood requesting the Administration to resolve the trucking issue.<sup>56</sup> The bipartisan group of Members stated that they want the issue to be resolved soon because the higher Mexican tariffs have had a “devastating” impact on local industries, especially in agriculture, and area economies in some states. One reported estimate states that U.S. potato exports to Mexico had fallen 50% by value since the tariffs were imposed and that U.S. exporters were losing market share to Canada.<sup>57</sup>

DOT Secretary LaHood stated in March 2010 that the Administration was very near a proposal that would meet the safety concerns of Congress. He stated that the reason the plan was taking so long was that it involved five different cabinet officials who needed to be notified of any changes in the plan.<sup>58</sup> Secretary of State Hillary Clinton also pledged to resolve the dispute over Mexican-registered trucks during a 2009 trip to Mexico. “We are working to resolve it,” she said and added that she anticipated Congress would be responsive to the Administration’s plans.<sup>59</sup>

### **Other Trade Issues**

The United States and Mexico resolved a long-standing trade dispute in 2006 involving sugar and high fructose corn syrup. Mexico argued that the sugar side letter negotiated under NAFTA entitled it to ship net sugar surplus to the United States duty-free under NAFTA, while the United States argued that the sugar side letter limited Mexican shipments of sugar. Mexico also

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<sup>53</sup> *International Trade Reporter*, “Obama, Mexico’s Calderon Promise to End Truck Dispute, Work Together on Energy,” April 29, 2009.

<sup>54</sup> CRS Report RL31738, *North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border*, by John Frittelli, Summary Page.

<sup>55</sup> *International Trade Reporter*, “Key GOP House Members Urge Obama to Develop New Mexico Truck Program,” March 26, 2009.

<sup>56</sup> *International Trade Reporter*, “Plan to Resolve Mexican Trucking Dispute ‘Very Near,’ DOT’s LaHood Tells Lawmakers,” March 11, 2010.

<sup>57</sup> *Ibid.*

<sup>58</sup> *Ibid.*

<sup>59</sup> Arshad Mohammed, “WRAPUP 2-U.S. to blame for much of Mexican drug violence,” *Reuters News*, March 25, 2009.

complained that imports of high fructose corn syrup (HFCS) sweeteners from the United States constituted dumping, and it imposed anti-dumping duties for some time, until NAFTA and WTO dispute resolution panels upheld U.S. claims that the Mexican government colluded with the Mexican sugar and sweetener industries to restrict HFCS imports from the United States.

In late 2001, the Mexican Congress imposed a 20% tax on soft drinks made with corn syrup sweeteners to aid the ailing domestic cane sugar industry, and subsequently extended the tax annually despite U.S. objections. In 2004, the United States Trade Representative (USTR) initiated WTO dispute settlement proceedings against Mexico's HFCS tax, and following interim decisions, the WTO panel issued a final decision on October 7, 2005, essentially supporting the U.S. position. Mexico appealed this decision, and in March 2006, the WTO Appellate Body upheld its October 2005 ruling. In July 2006, the United States and Mexico agreed that Mexico would eliminate its tax on soft drinks made with corn sweeteners no later than January 31, 2007. The tax was repealed, effective January 1, 2007.

The United States and Mexico reached a sweetener agreement in August 2006. Under the agreement, Mexico can export 500,000 metric tons of sugar duty-free to the United States from October 1, 2006, to December 31, 2007. The United States can export the same amount of HFCS duty-free to Mexico during that time. NAFTA provides for the free trade of sweeteners beginning January 1, 2008. The House and Senate sugar caucuses expressed objections to the agreement, questioning the Bush Administration's determination that Mexico is a net-surplus sugar producer to allow Mexican sugar duty-free access to the U.S. market.<sup>60</sup>

On tuna issues, the Clinton Administration lifted the embargo on Mexican tuna in April 2000 under relaxed standards for a dolphin-safe label in accordance with internationally agreed procedures, and U.S. legislation passed in 1997 that encouraged the unharmed release of dolphins from nets. However, a federal judge in San Francisco ruled that the standards of the law had not been met, and the Federal Appeals Court in San Francisco sustained the ruling in July 2001. Under the Bush Administration, the Commerce Department ruled on December 31, 2002, that the dolphin-safe label may be applied if qualified observers certify that no dolphins were killed or seriously injured in the netting process, but Earth Island Institute and other environmental groups filed suit to block the modification. On April 10, 2003, the U.S. District Court for the Northern District of California enjoined the Commerce Department from modifying the standards for the dolphin-safe label. On August 9, 2004, the federal district court ruled against the Bush Administration's modification of the dolphin-safe standards and reinstated the original standards in the 1990 Dolphin Protection Consumer Information Act. That decision was appealed to the U.S. Ninth Circuit Court of Appeals, which ruled against the Administration in April 2007, finding that the Department of Commerce did not base its determination on scientific studies of the effects of Mexican tuna fishing on dolphins. In late October 2008, Mexico initiated World Trade Organization dispute proceedings against the United States, maintaining that U.S. requirements for Mexican tuna exporters prevents them from using the U.S. "dolphin-safe" label for its products.<sup>61</sup>

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<sup>60</sup> "Bush Administration Defends Sugar Deal to Congress," *Inside U.S. Trade*, November 3, 2006; "Grassley, U.S. Industry Welcome Agreement with Mexico on Sugar, HFCS," *International Trade Reporter*, August 3, 2006; and, "U.S., Mexico Reach Agreement on WTO Soft Drink Dispute Compliance Deadline," *International Trade Reporter*, July 13, 2006.

<sup>61</sup> *International Trade Reporter*, "Mexico Initiates WTO Dispute Proceeding Against U.S. 'Dolphin-Safe' Label for Tuna," October 30, 2008.

On other issues, in early October 2002, the U.S.-Mexico working group on agriculture dealt with major agricultural issues, including Mexico's anti-dumping decisions on apples, rice, swine, and beef, and safeguard actions on potatoes. In January 2003, the countries agreed to permit Mexican safeguard measures against U.S. imports of chicken legs and thighs, and in July 2003, these safeguard measures were extended until 2008, with tariffs declining each year. In September 2006, Mexico revoked anti-dumping duties imposed on U.S. rice imports in 2002 following rulings by the WTO and WTO Appellate Body in 2005, which found that the duties were contrary to WTO rules. Mexico banned beef imports from the United States in December 2003 following the discovery of one cow infected with mad cow disease in Washington State. Mexico resumed importation of boneless beef in early March 2004, and bone-in beef in February 2006, in response to improved beef cattle screening.

## Policy Issues

The United States' economic relationship with Mexico has strengthened significantly over the last decade and is of mutual importance. Up to this point, the discussion in the report has focused on the background and surrounding issues of the economic relationship, which leads to the issue of policy considerations. First, there is the question of whether to further economic integration with Mexico in view of the increasing trends in regional trade agreements throughout the world. The close economic relationship between the United States and Mexico that was strengthened by NAFTA is likely to continue but there may be challenges in coming years as the influence of China and other low-wage countries increases. According to a recent study on economic integration in North America, a major shift is under way in trade patterns among NAFTA partners with exports among NAFTA economies growing more slowly than their exports with the rest of the world, reversing the previous 10-year trend. The report finds that lower-cost suppliers, primarily China and India, are displacing North American imports and could weaken North American integration. The report states that furthering continental integration would require "renewed efforts at resolving long-standing trade disputes, new liberalization initiatives, or greater policy harmonization in areas such as border security, labor mobility, or corporate taxation."<sup>62</sup>

If the United States continues to deepen economic integration with Mexico, one area that may need more attention is the issue of the difference in income levels between the two countries. The economic relationship with Mexico is unique because of Mexico's proximity to the United States, but also because of the wide differences in levels of economic development between the two countries. Mexico is the first developing country with which the United States entered into a free trade agreement. In Mexico, NAFTA has had an uneven effect in different parts of the country and it has not been a solution to the problem of poverty and unemployment. Mexico's problem with poverty cannot be attributed directly to NAFTA because it was in existence prior to the agreement. At the time of NAFTA there was hope that Mexico's economy would grow sufficiently to create jobs in urban areas and help alleviate poverty in rural areas. However, the economy did not expand as expected and the problem of poverty continues.

Another policy option that has been mentioned is withdrawal from NAFTA. Legislation was introduced in the 111<sup>th</sup> Congress for the United States to withdraw from NAFTA (H.R. 4759). The

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<sup>62</sup> ITR, "North American Integration Slipping Due to China's Strong Growth, Report Says," Volume 22, Number 8, February 24, 2005.

bill would require the President to give written notice to Mexico and Canada of the U.S. withdrawal, which would occur six months after the bill's enactment. The bill had 27 co-sponsors and was referred to the House Ways and Means Committee. Supporters of the bill believe that NAFTA did not live up to its promises and that it has resulted in large job losses in the United States and Mexico. Opponents of the bill believe that NAFTA has had "incredible" successes in all three countries of North America and that withdrawing from NAFTA would cause job losses in the United States to increase and that U.S. exports to Mexico would be sharply impacted. They point to the losses in exports that have occurred already from Mexico's retaliatory tariffs due to the trucking dispute and state that those exports represent only a small percentage of total U.S. exports to Mexico.<sup>63</sup>

Another policy issue relates to whether trade agreements are enough, or are the appropriate policy instrument, to resolve income disparities among trading partners or even within a developing country. The World Bank study on the effects of NAFTA on Mexico concludes that NAFTA has helped to improve economic conditions in Mexico but it has not been enough to narrow the economic disparities with the United States. The authors of the study state, among other things, that Mexico needs to invest more in education, infrastructure, and institutional strengthening to benefit more fully from freer trade.<sup>64</sup> A possible consideration for policymakers is whether to help Mexico improve the quality of education and strengthen its national institutions through foreign aid programs or other mechanisms.

The economic hardship in certain sectors and regions of Mexico has been a major reason behind unauthorized Mexican migration to the United States. Mexican President Felipe Calderón made his first official visit to the United States as President-elect in early November 2006, after first visiting Canada and several Latin American countries. During his visit, Calderón criticized the recent authorization of fencing along the U.S.-Mexico border and noted that it complicated U.S.-Mexico relations. He asserted that job creation and increased investment in Mexico would be more effective in reducing illegal migration from Mexico than a border fence. Calderón signaled a shift in Mexican foreign policy when he noted that while immigration is an important issue in the bilateral relationship, it is not the only issue, as trade and economic development are also important.

Mexico has voiced concern in the past about alleged abuses suffered by Mexican workers in the United States and for the loss of life and hardships suffered by Mexican migrants as they use increasingly dangerous methods to cross into the United States. During his administration, former Mexican President Vicente Fox held the view that the migrants are "undocumented workers" and that because the U.S. market attracts and provides employment for the migrants, it bears some responsibility. He pressed proposals for legalizing undocumented Mexican workers in the United States through amnesty or guest worker arrangements as a way of protecting their human rights. In 2004, President Bush proposed an overhaul of the U.S. immigration system to permit the matching of willing foreign workers with willing U.S. employers when no U.S. documented workers could be found to fill the jobs.

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<sup>63</sup> *International Trade Reporter*, "Legislation for Withdrawal from NAFTA Introduced in House with Bipartisan Support," March 11, 2010.

<sup>64</sup> The World Bank, *Lessons from NAFTA for Latin America and the Caribbean*, by Daniel Lederman, William F. Maloney, and Luis Servén, 2005.

The U.S. Senate began consideration of comprehensive immigration reform in May 2007. Mexico had long lobbied for immigration reform in the United States and cautiously watched the debate in 2007 on this measure. Legal immigration reform stalled in the 110<sup>th</sup> Congress. It is unclear whether the 111<sup>th</sup> Congress will attempt to tackle comprehensive immigration reform. It may, however, consider legislation on selected immigration reform issues, such as foreign workers. Additional border security measures may also be considered.

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